

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Lewis Analyst: Kimberly Pantoja Bill Number: SB 1948

Related Bills: None Telephone: 845-4786 Introduced Date: 02/24/2000

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Preschool Tuition Credit

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a credit for each taxable year for preschool tuition in an amount equal to 100% of the amount paid or incurred, not to exceed \$500, for any child of the taxpayer that is between three and five years of age at the time of payment.

EFFECTIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would apply to taxable years beginning on or after January 1, 2000, and before January 1, 2006.

SPECIFIC FINDINGS

Existing federal and state laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities which they may not otherwise undertake.

Existing federal and state laws provide various tax credits that are used to reduce the taxpayer's tax liability dollar-for-dollar. Tax credits, unlike deductions, are claimed after taxable income has been calculated and do not create differences between the taxable income amounts shown on the federal and state income tax returns.

Existing state law allows taxpayers to claim personal exemption credits for themselves, their spouses, and their dependents. To claim this exemption credit for a dependent, certain tests must be met including the requirement that the taxpayer provide more than one-half of the dependent's support. However, in cases of divorce or separation, the custodial parent is generally allowed the dependency exemption credit unless that parent chooses to release that exemption credit to the noncustodial parent.

Existing state law provides general rules that apply to the division of credits among two or more taxpayers, a husband and wife, and partners.

Board Position:

<u> </u> S	<u> </u> NA	<u> </u> NP
<u> </u> SA	<u> </u> O	<u> </u> NAR
<u> </u> N	<u> </u> OUA	<u> </u> X PENDING

Department Director

Date

Alan Hunter for GHG

3/28/00

Current state and federal laws do not provide a tax credit for preschool tuition.

This bill would allow a credit for each taxable year for preschool tuition in an amount equal to 100% of the amount paid or incurred, not to exceed \$500, for any child of the taxpayer that is between three and five years of age at the time of payment.

This bill specifies the preschool tuition credit shall only be allowed for tuition paid or incurred to a preschool that is licensed by this state.

This bill would allow any unused credit to be carried over until exhausted. Since **this bill** does not specify otherwise, the general rules in state law that apply to the division of credits among two or more taxpayers would apply.

Implementation Considerations

It is unclear if the credit limitation of \$500 per taxable year is intended to apply on a per taxpayer basis or on a per child basis (in which case one taxpayer may claim more than \$500 per year). The language of the bill could be interpreted both ways. Clarification of the author's intent is needed to avoid disputes with taxpayers and ease the administration of the credit.

"Child of the taxpayer" is not clearly defined. Without a support test such as that provided for the dependency exemption, it appears that, in the case of a divorce or separation, the same child could qualify each parent for the credit.

Although the bill specifies "preschool that is licensed as such by the state," the term "preschool" should be further defined to clarify the author's intent. Preschools and child care facilities receive the same licensing from the Department of Social Services (DSS) and therefore are difficult to distinguish based on that specification.

This bill does not limit the number of years for the carryover. The department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

FISCAL IMPACT

Departmental Costs

Once the implementation concerns are resolved, this bill is not expected to significantly impact the department's costs.

Tax Revenue Estimate

Based on data and assumptions discussed below, revenue losses from this bill are projected to be as follows:

Estimated Revenue Impact of SB 1948 Assumed Effective After 12/31/99 with Enactment Assumed After 6/30/2000 (In \$Millions)			
Fiscal Years	2000-01	2001-02	2002-03
Revenue Impact	(\$150)	(\$140)	(\$145)

Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Tax Revenue Discussion

Revenue losses would depend on the amount of qualified credit claims and tax liabilities of qualified taxpayers in any given year.

According to the 1999 report "The California Child Care Portfolio" and other available information, licensed child care/preschool facilities had about 284,200 slots (prorated for children age 3-5) and family child care houses with nearly 130,000 spaces. (Since DSS issues the same license for all types of day care, it is impossible to distinguish "preschools.") It is projected that total qualified slots for this proposal, excluding state-funded slots, were approximately 370,000 in year 1998.

To approximate qualified taxpayers, a simulation based on state tax returns filed by filing status with dependents claimed, adjusted gross incomes, and average income tax liability were used. Average tuition costs in California range from \$2,600 to \$8,200 per year (1996/97 level). Lower average costs were used for AGIs below \$50,000. Average costs were expanded to year 2000 and beyond by applying projected state CPI rates. Total qualified preschool slots were distributed proportionately in accordance with the distribution of returns with dependents claimed.

Based on these simulations, it is projected for tax year 2000 that approximately 381,000 children would qualify taxpayers to claim an average applied credit of \$345 for a revenue loss of \$131 million. The growth rate was based on the Department of Finance Birth Projection for years 1995-1997. The 2000-1 estimate above reflects this impact plus allowance for some reduced estimated tax payments for the first half of 2001.

BOARD POSITION

Pending.